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FROM USOECD PARIS

BRUSSELS FOR USEU

FRANKFURT FOR TREASURY ATTACHE

TREASURY FOR IA -- LESLIE HULL

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SUBJECT: OECD SURVEY OF EURO AREA ECONOMY: FOCUS ON  
FISCAL OVERRUNS

CONTAINS REPORT OF OECD MEETING -- NOT FOR INTERNET  
DISTRIBUTION

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SUMMARY AND INTRODUCTION  
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**11.** (U) The Economic and Development Review Committee of the OECD conducted an economic review of the euro area on May 17, 2005. The last such review was held in June 2004. Mr. Jean Guill, Director of Treasury in the Luxembourg Ministry of Finance (Luxembourg currently holds the EU presidency); Mr. Klaus Regling, Director General for Economic and Financial Affairs at the European Commission and Mr. Phillippe Moutot, Deputy Director General for Economics at the European Central Bank led the euro area team of 13. Japan and Switzerland were the lead examining countries. The focus of the review was the Stability and Growth Program and ECB monetary policy. The United States raised again the APEC/EU level playing field problem. End summary and introduction.

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FISCAL POLICY  
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**12.** (U) The euro area delegation objected to the draft survey's characterization that the rules under the stability and growth pact (SGP) had been loosened in a March 2005 decision, stressing to the contrary that the rules have been strengthened. Australia said there appeared to be very little broad-based commitment to fiscal consolidation in Europe, a remark which prompted the EC's Regling to call "outrageous". Regling also objected to the survey's observation that the EU Council of Ministers were "party and judge" in deciding what action to recommend in correcting excessive deficits. He could not imagine it being any other way.

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MONETARY POLICY  
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**13.** (U) On monetary policy, the ECB's Moutot criticized the survey's recommendation that the ECB hold its interest rate stable as long as indicators stay mixed, but act as soon as it tilts the assessment in one or the other direction. OECD chief economist Jean Phillippe Cotis interjected that, because of recent bad first quarter growth figures from Italy and Portugal as well as continued weakness in consumer and business confidence, the OECD is scaling back its outlook for the euro area and will assume that the ECB will cut its interest rate by 50 basis points. "This is a very disturbing time for the monetary union", he said.

**14.** (U) The euro area delegation, supported by Switzerland, argued that risks were greater on the inflation side, while the Secretariat supported the view that a significant output gap had emerged and that core inflation was under control. The discussion was frustrating and inconclusive, as the Secretariat was weakened by not having its new outlook

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numbers available (they were announced at a press conference on May 24) and that individual EU member nations did not speak.

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APEC/EU ISSUE, AGAIN  
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**15.** (U) On structural policy, the euro area delegation appeared much more inclined to accept the Secretariat's recommendations that the Commission resist a watering down of the services directive, wrap up unfinished business in

financial and transport sectors and work towards supra-national innovation policies. Reacting to Regling's frequent comparisons of the EU with the United States, the U.S. delegate noted that the USG found such exercises useful and instructive. The EDRC examines all aspects of U.S. economic policy, as well as that of other non-EU countries. In this regard, it would be useful for all countries if the European Union allowed all of its policies to be examined, in a similar manner. Regling said he understood the problem had been raised again at the Ministerial meeting and that the EU was working on a response.

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COMMENT  
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16. (SBU) Comment: The body language of the Europeans around the table displayed alternating anxiety and disgruntlement, but according to one EU member country with whom we spoke on the following day, they had agreed to let the euro area delegation speak for the group. This led inevitably to a rather impoverished discussion. Other EU delegates with whom we spoke after the meeting indicated a strong preference for an ECB rate cut, even though they were not sure it would do much good. While impressed with Regling's defense of the SGP, they left little doubt that they, too, looked at the revised version as a weakening. They also signaled that this was a political reality, and not necessarily a bad thing. End comment.

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